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MEMORANDUM
September 27, 2007

TO: Honorable Councilmembers
Mike Aguirre, City Attorney

FROM: Mayor Jerry Sanders

SUBJECT: Effective Date of July 1, 2005 Negotiated Retirement Benefit Changes

The San Diego City Employees' Retirement System (SDCERS) has informed the City that they are using an effective date of February 16, 2007 for the benefit changes that were negotiated in 2005. They have asserted that they will not recognize an effective date of July 1, 2005 because the City Attorney did not memorialize the Memoranda of Understanding (MOU's) into ordinances "in a timely manner" as is called for in the documents.

There are now two competing legal opinions on this issue: one from SDCERS fiduciary counsel, Harvey Leiderman at the firm of ReedSmith, and one from a firm hired by the City Attorney, K&L Gates. With no solution in sight, I am recommending to the City Council that the City file a Declaratory Relief action in San Diego Superior Court and allow a judge to decide the issue. I am also recommending that the City Council retain outside counsel, reporting jointly to the Council and me, to handle this matter because of the City Attorney's role in creating this conflict.

Approximately 700 new City employees were hired between July 1, 2005 and February 16, 2007. If SDCERS is correct, the City will expend tens of millions of dollars over the next several years given that the DROP program, Pension Service Credits and retiree healthcare will be benefits made available to these recent hires. Both our pension and retiree health liabilities will rise. Clearly, this is not something that I support nor do I believe is in the best interest of the taxpayers. By way of this memo, I am also informing SDCERS trustees and management of my recommendation. I ask that SDCERS have prepared an actuarial valuation of this potential liability.

The simple fact is that none of this would be a problem today if the City Attorney had simply done his job and memorialized the MOU's into ordinances in a timely manner. On a number of occasions, Council President Peters and I urged the City Attorney, in person and in writing, to codify the MOU's. Our requests were ignored.

I ask the City Council to consider this recommendation immediately so that we can settle this matter.

Thank you.

cc: Board of Trustees, SDCERS
David Wescoe, SDCERS Administrator
Andrea Tevlin, IBA

Attachments

(500)

REQUEST FOR COUNCIL ACTION
CITY OF SAN DIEGO

1. CERTIFIC/ (FOR AUI ER ONLY)

TO:	2. FROM (ORIGINATING DEPARTMENT):	3. DATE:
Council President	Office of the Mayor	October 5, 2007

4. SUBJECT:
Retention of Outside Counsel and Declaratory Relief Actions related to Retirement Benefit Changes

5. PRIMARY CONTACT (NAME, PHONE & MAIL STA.)	6. SECONDARY CONTACT (NAME, PHONE & MAIL STA.)	7. CHECK BOX IF REPORT TO COUNCIL IS ATTACHED
Jay Goldstone	Ed Plank	☐

8.COMPLETE FOR ACCOUNTING PURPOSES

FUND	81140			
DEPT.	82240			
ORGANIZATION				
OBJECT ACCOUNT	4100			
JOB ORDER	82240			
C.I.P. NUMBER				
AMOUNT				

9. ADDITIONAL INFORMATION / ESTIMATED COST:
See attached Memorandum from Mayor Sanders dated September 27, 2007 for additional information

10. ROUTING AND APPROVALS

ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED	ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED
1	ORIGINATING DEPARTMENT	[signature]	10-5-07	8	DEPUTY CHIEF		
2				9	COO	[signature]	10.5.07
3				10	CITY ATTORNEY		
4				11	ORIGINATING DEPARTMENT		
5				✓	DOCKET COORD: _____ COUNCIL LIAISON: _____		
6					COUNCIL PRESIDENT ☐ SPOB ☐ CONSENT ☐ ADOPTION		
7					_____ ☐ REFER TO: _____ COUNCIL DATE: _____		

11. PREPARATION OF: X RESOLUTION(S) ☐ ORDINANCE(S) ☐ AGREEMENT(S) ☐ DEED(S)

Please docket the following actions for Council consideration:

1. Authorize the Mayor to retain outside legal Counsel, reporting jointly to the City Council and to the Mayor, to provide legal services related to determining the effective date of retirement benefit changes for employees hired between July 1, 2005 and February 16, 2007
2. Authorize initiation of litigation, to include a Declaratory Relief Action and other actions as necessary, to determine the effective date of the retirement benefit changes
3. Authorizing the City Auditor to appropriate the necessary funding from the Public Liability Fund and to expend these funds for outside counsel fees related to this action
4. Directing the City Attorney to prepare the necessary resolutions associated with these actions

11A. STAFF RECOMMENDATIONS:
1. Approve the recommended actions

12. SPECIAL CONDITIONS:

COUNCIL DISTRICT(S):

COMMUNITY AREA(S):

ENVIRONMENTAL IMPACT:

HOUSING IMPACT:

OTHER ISSUES:

OFFICE OF MAYOR JERRY SANDERS
CITY OF SAN DIEGO

MEMORANDUM

DATE : August 9, 2006

TO : City Attorney Michael Aguirre

FROM : Mayor Jerry Sanders

SUBJECT: Follow-up on Codifying FY 2006 and FY 2007 Memoranda of Understanding (MOU)

Council President Scott Peters sent two memoranda, one on May 15, 2006 and another on July 19, 2006 (see attached) regarding the codification in the San Diego Municipal Code of the MOUs with City's labor organizations for the fiscal years 2006 and 2007. These MOUs, though approved by the City Council and Mayor, have not yet been added to the municipal code. I respectfully request that your office make the necessary changes to avoid serious financial consequences to the City and the San Diego City Employees Retirement System.

Please update the City Council and me on the status of these items and submit any appropriate items to be docketed at the September 11, 2006 City Council meeting. I look forward to working with you on these matters.

JS/jg

cc: Honorable City Councilmembers
Ronne Froman, COO
Jay Goldstone, CFO
Andrea Tevlin, IBA
David Wesco, SDCERS Retirement Administrator

From: "Karen Heumann" <kheumann@sandiego.gov>
Sent: Thu, October 04, 2007 6:22 PM
To: "Jaymie Bradford" <JBradford@sandiego.gov>
Cc: "Judy Bagwell" <JBagwell@sandiego.gov>, "Kathryn Burton" <KBurton@sandiego.gov>
Subject: Closed Session Docket

Dear Jaymie,

This is a followup to our telephone conversation-
I understand that the Mayor's office would like to have docketed for closed session an item titled City of San Diego v. SDCERS regarding the Mayor's desire to file a declaratory relief action and potential retention of outside counsel. Because this matter has been largely discussed in the media and in televised press conferences, we are not aware of any aspect of the discussion that would require a confidential proceeding. The positions of the participants are already public. Therefore, it would be more appropriate to docket this item for open session. Perhaps Council President Peters would allow the addition of a supplemental open session docket item in this case to accommodate your request.

Please let me know if there are any additional facts or concerns that you have that would warrant holding a closed session meeting on this matter.

Thank you.

Sincerely,
Karen Heumann

Karen Heumann
Assistant City Attorney
Civil Division Policy
Advisory and Litigation
San Diego City Attorney's Office
619-533-5867
kheumann@sandiego.gov

City of San Diego
COUNCIL PRESIDENT SCOTT PETERS
DISTRICT ONE

MEMORANDUM

DATE: May 15, 2006

TO: City Attorney Michael Aguirre

FROM: Council President Scott Peters

SUBJECT: Ordinance Codifying FY 2006 Meet and Confer

In March 2006, San Diego City Employee Retirement System ("SDCERS") forwarded several pending ordinances to both the Mayor's Office and my office. In addition, on April 5, SDCERS forwarded to my office a Request for Council Action and proposed ordinance combining three of the pending ordinances, in order to bring the retirement plan into compliance with: (1) Federal Tax Law; (2) California law regarding Domestic Partners; and (3) the Gleason Settlement Agreement. It is my understanding that your office is working on recommended amendments relating to the City's retirement plan provisions.

An additional issue presented to the City was for the City Council to adopt an ordinance codifying the benefit changes from the FY 2006 Memoranda of Understanding ("MOU"). SDCERS contends that without adopting an ordinance amending the retirement provisions in the Municipal Code, SDCERS does not have the ability to carry out the intent of the parties involved in the FY 2006 MOU. This has caused confusion among City Employees hired after July 1, 2005 and could lead to serious financial consequences in the future. If the Council adopts such ordinance, SDCERS has informed me that they will carry out an election among its members to vote on the proposed ordinance as required by Charter section 143.1.

I respectfully request that you update the Mayor and Councilmembers on the status of the ordinance language related to the FY 2006 MOU and submit the appropriate items to be docketed at a City Council meeting at the earliest possible date. Thank you very much for your assistance.

SHP:wjs

CC: Honorable Mayor and City Councilmembers
Ronnie Froman, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
Jay Goldstone, Chief Financial Officer
Peter Preovolos, SDCERS Board President
David Wesco, SDCERS Retirement Administrator

City of San Diego
COUNCIL PRESIDENT SCOTT PETERS
DISTRICT ONE

MEMORANDUM

DATE: July 19, 2006

TO: Honorable City Attorney Michael Aguirre

FROM: Council President Scott Peters

SUBJECT: Follow up on Codifying FY 2006 Memoranda of Understanding ("MOU")

On July 12, 2006, the San Diego City Employee Retirement System's ("SDCERS") Navigant Subcommittee voted unanimously to approve a resolution requiring all changes to the city retirement plan be adopted by ordinance and that the docketing of any such plan amendment ordinance be preceded by official notification from the City to SDCERS. If SDCERS' board adopts this resolution at their July 21st board meeting, SDCERS will administer the plan set forth in the San Diego Municipal Code ("SDMC") and not the FY 2006 MOUs or any other City Council resolutions that have not been incorporated into the SDMC by ordinance. In addition, the FY 2007 MOUs with San Diego City Fire Fighters Local 145 and the Deputy City Attorneys also need to be codified in the SDMC.

My memorandum to you on May 15, 2006 (attached), detailed the seriousness of this matter. I respectfully request that you submit the appropriate items to be docketed at a City Council meeting at the earliest possible date. I look forward to working with you on this matter. Thank you.

SHP:wjs

CC: Honorable Mayor and City Councilmembers
Ronne Froman, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
Jay Goldstone, Chief Financial Officer
David Wesco, SDCERS Retirement Administrator

SDCERS
San Diego City Employees' Retirement System

CHRISTOPHER W. WADDELL
General Counsel
(619) 525-3614
e-mail:CWaddell@sandiego.gov

August 3, 2007

Mr. Scott Chadwick
Labor Relations Manager
City of San Diego
1200 Third Avenue, Suite 1316
San Diego, CA 92101-3869

Dear Scott:

Subject: Effective Date of July 1, 2005 Negotiated Retirement Benefit Changes

The purpose of this letter is to confirm that SDCERS is using an effective date of February 16, 2007 for the benefit changes that were negotiated in 2005. Therefore, these changes will not be applied to employees hired by the City before that date.

As reflected in the attached legal opinion from our fiduciary counsel, SDCERS is obligated to administer benefits in accordance with its plan documents, and neither memoranda of understanding (MOU's) nor terms and conditions imposed post-impasse constitute plan documents. As noted in the opinion, the MOU's themselves required the City, "in a timely manner," to make the necessary changes in ordinances to conform to the MOU's, with a target date of September 30, 2005. Unfortunately, the City did not enact such an ordinance until January 17, 2007, more than a year later, and the ordinance took effect 30 days later on February 16, 2007.

Further, as noted in the legal opinion, any attempt to retroactively implement the ordinance to July 1, 2005 likely would be met by a legal challenge that such action constituted an impairment of rights and we believe it is highly unlikely that a court would apply the reduced benefit levels in the MOU's to new employees hired on or after July 1, 2005 and before February 16, 2007.

For these reasons, SDCERS will continue to advise City employees hired before February 17, 2007 that they are eligible for the retirement benefits in place prior to the 2006 MOU changes and will advise City employees hired on or after that date that they will be subject to the negotiated benefit reductions.

If you have any questions about this issue or would like to discuss it further, please call me.

Sincerely,

Christopher W. Waddell
General Counsel

CWW/mrh

Attachment

Cc SDCERS Board Members
David B. Wescoe, Retirement Administrator
David Arce, SDCERS
Rebecca Wilson, SDCERS
Jay Goldstone, Chief Financial Officer and Acting Chief Operating Officer
Rich Snapper, Personnel Director
Greg Bych, Risk Management Director
Lisa Briggs, Policy Advisor
William Gersten, Deputy City Attorney

K&L|GATES MEMORANDUM

TO: William Gersten

FROM: Norman S. Milks
Heidi Eckel Alessi

DATE: August 24, 2007

RE: Effective Date of July 1, 2005 Negotiated Retirement Benefit Changes

The following is our analysis in response to San Diego City Employees Retirement System's (SDCERS) assertion that negotiated changes to the defined benefit plan do not take effect until February 17, 2007. Our analysis is based on the tax qualification requirements of the Internal Revenue Code of 1986, as amended, and principles of the Employee Retirement Income Security Act of 1974, as amended, (ERISA) that are applied in analogous situations. Although ERISA is not applicable to governmental plans, case law interpreting ERISA's written plan requirement and amendment procedures is persuasive authority since the Internal Revenue Code has a parallel writing requirement. In addition, SDCERS purports to rely on tax qualification rules and ERISA requirements by analogy.

Background

SDCERS sent a letter dated August 3, 2007, to "confirm that SDCERS is using an effective date of February 16, 2007 for the benefit changes that were negotiated in 2005." The letter further advises that "SDCERS will continue to advise City employees hired before February 17, 2007 that they are eligible for the retirement benefits in place prior to the 2006[1] MOU changes." SDCERS asserts that the MOU is not a "Plan document" and that the Plan was not amended until January 17, 2007, when the City passed Ordinance O-19567.

SDCERS's position is based on a legal opinion from Reed Smith, referred to as its fiduciary counsel, dated May 4, 2007. Reed Smith's legal opinion asserts that "[a]ccording to SDCERS's tax counsel, Ice Miller, LLP, SDCERS' 'plan document' is comprised of portions of the state Constitution, the City Charter, the City Municipal Code, and portions of specified MOUs not codified in the City's charter or Municipal Code but incorporated by specific reference in the Code (these MOUs relate to credit for certain union presidents' service and compensation)." Notably, the alleged opinion of Ice Miller is stated as an "undisputed fact"

[1] We assume that this is a typographical error and that SDCERS intended to refer to the 2005 Memorandum of Understanding.

which compels Reed Smith to conclude that the MOU can be disregarded until its terms were codified.

According to Reed Smith's letter, the City of San Diego entered into a series of Memoranda of Understanding (collectively referred to as MOU), dated as of July 1, 2005, which documented negotiated changes to "ancillary benefits" of the defined benefit plan including (1) a 13th retirement check payable whenever there are excess earning available in the retirement system at the end of the year, (2) a Deferred Option Program (DROP), (3) the right to purchase up to five years of additional service credit, and (4) retiree medical benefits. The MOU provides that employees first hired on or after July 1, 2005, would not be eligible for these "ancillary benefits." The MOU is also described as changing the retirement allowance formula for the "new hires" to a fixed formula not subject to future increases. Reed Smith also notes that the City Counsel passed Resolution No. R-300600, on June 27, 2005, approving and ratifying the MOU to be effective July 1, 2005. On January 17, 2007, the City adopted an Ordinance to codify the changes included in the MOU and ratified in the Resolution.

Also according to Reed Smith, SDCERS has advised employees hired since July 1, 2005, that it would disregard the terms of the MOU until an ordinance is passed to codify the changes in the Municipal Code. As you know, on July 21, 2006, the Board of Administration adopted Resolution No. R 6-05, which purports to require that all changes to the City's retirement plan be effected only when enacted by ordinance. The Resolution provides, in part:

> WHEREAS, in order for SDCERS to properly administer the retirement benefits established by the City for its employees, and to satisfy its duties under federal tax law, all retirement benefit changes effecting City employees must be enacted by ordinance amending SDMC Chapter 2, Article 4 ...
>
> NOW THEREFORE, BE IT RESOLVED, that the Board will administer retirement benefits of City employees and retirees in accordance with the terms of the City's retirement plan, as set forth in SDMC Chapter 2, Article 4, and will not implement any benefit changes that have not been enacted by an ordinance amending the plan and, where required, a majority vote of the SDCERS membership....

In essence, the SDCERS Resolution purports to prescribe the plan amendment procedures.

For the purpose of responding to the arguments regarding the effective date, we have assumed that these facts (not including Ice Miller's legal opinion) are accurate because. We would conclude that the MOU is a "plan document" and that the Plan was amended by the City Council's resolution ratifying the MOU. It would be helpful to review the MOU and the City Council's resolution because there may be additional terms not described by Reed Smith that

would support our analysis. We were unable to find Resolution No. R-300600 on the City's website.

Analysis

A. Plan Documents

One of the basic tax qualification requirements for a retirement plan is that the plan must be "a definite written program and arrangement" established and maintained by the employer. Treas. Reg. 1.401-1(a)(2). "A failure to follow the terms of the plan" *may* be an "operational failure" *if* it cannot be corrected. Rev. Proc. 2006-27, §5.01(2)(b). This does not mean, however, that a pension plan may consist of only one document or certain types of documents. *See e.g., Pegram v. Herdrich,* 503 U.S. 211, 223 (2000). A "plan" is a group of rights, benefits, and procedures set up by an employer to create pension and welfare benefits. *Orth v. Wisconsin State Employees Union Council,* 2007 WL 1556542 (Slip. Op. May 25, 2007), citing *Pegram,* 503 U.S. at 223. "The plan may be evidenced by a summary plan description (SPD) and any other documents, such as a CBA, that describes the rights of beneficiaries or such things as how the plan is administered ..." *Orth,* at *9 (emphasis added). ERISA, which mirrors the tax code's writing requirement, specifically refers to plan documents and instruments in the plural form. 29 U.S.C. §1104(a)(1)(D) (a plan must be administered in accordance with the documents and instruments governing the plan"). "There is no requirement that documents claimed to collectively form the employee benefit plan be labeled as such." *Horn v. Berdon, Inc. Defined Benefit Pension Plan,* 938 F.2d 125 (9th Cir. 1991).[2]

Courts typically consider "what constitutes the plan documents" by examining whether one or more of the proposed documents set forth terms related to the benefits and whether the employer intended to be bound by the terms set forth in such documents. *See Cinelli v. Security Pacific Corp.,* 61 F. 3d 1437 (9th Cir. 1995). Informal letters or resolutions describing benefits that might be offered in the future would not be considered plan documents because such documents were never intended to bind the employer. *See id.*

In contrast, where a negotiated agreement contains terms related to a pension plan, the negotiated agreement is considered to be one of the plan documents. *See e.g., Bozetarkik v.*

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[2] Reed Smith's letter states that "for government plans qualified under Internal Revenue Code ("Code") section 401(a), such as SDCERS, the "plan document consists of its governing statutes and laws, rules and regulations." The Internal Revenue Code, however, does not define what documents may be considered "plan documents" for government plans. *See* Treas. Reg. 1.401-1(a)(2). Notably, the assertion that a government plan document may only consist of such things would contradict the alleged opinion of Ice Miller that the plan documents include "portions of specified MOUs."

Mahland, 195 F.3d 77, 81 (2d Cir. 1999) (finding that the collective bargaining agreement and other pension plan statements must be read together "as a whole"); *Wilson v. Moog Auto., Inc. Pension Plan & Trust for U.A.W. Employees,* 193 F. 3d 1004, 1008 (8th Cir. 1999) (noting that ERISA's goals of putting "participants on notice of the benefits to which they are entitled and their own obligations under the plan," and of "providing guidelines, that likewise are known to the participants, for the plan administrator as he makes coverage decisions," "are not thwarted by counting the [collective bargaining] Agreement among the plan documents to be considered in administering the Company's Pension Plan."); *Central States, Southeast and Southwest Areas Pension Fund v. McClelland,* 23 F. 3d 1256 (7th Cir. 1994) ("the collective bargaining and contribution agreements establish the employer's obligation to the pension fund") (emphasis added); *Int'l Union of Elec. Salaried, Mach. & Furniture Workers, AFL-CIO v. Murata Eria N. Am. Inc.,* 980 F. 2d 889, 894 (3d Cir. 1992) (explaining that "the collective bargaining agreement is considered part of the Plan documents under ERISA.").

The *Picard* case cited in Reed Smith's letter does not stand for the proposition that union agreements are not plan documents or that their terms do not become plan terms. *See Picard v. Members of the Employee Retirement Board of Providence,* 275 F. 3d 139 (1st Cir. 2001). In that case, representatives for the City of Providence, Rhode Island and its bargaining units negotiated and agreed to a series of collective bargaining agreements providing for a 5% compounded cost of living increase. The Providence Code required the City Council to ratify all collective bargaining agreements and it was undisputed that the City Council did not ratify the CBAs. The First Circuit explained:

> "Plaintiff's assert that a series of CBAs negotiated but never ratified by the City Council created a vested right in the higher COLA benefit. Yet, the Supreme Court of Rhode Island has repeatedly held that a CBA that is not ratified by the City Council is void and unenforceable."

Id. at 144. Thus, in that case, there was no CBA. We believe the result would have been different if, as in this case, the CBA had been ratified by the city council. Reed Smith's letter acknowledges that the MOU was indeed ratified by the City Council on June 27, 2005.

We believe that the MOU would most likely be considered to be a "plan document" by a court and the Internal Revenue Service because the employer and the bargaining units' representatives intended for it to represent their final agreement regarding certain benefits, intended for it to be effective on a specific date, and it was ratified by the City Council. There is no claim that the MOU was void, defective or unauthorized.

Reed Smith's letter does not provide any analysis or authority to conclude that the MOU should not be considered a plan document. Instead, the letter starts with an analysis of the duty to administer plan benefits in accordance with the plan documents while assuming as a matter of "undisputed fact" that the MOU is not a plan document. The letter argues that the parties did not intend for the benefit changes to take effect until an ordinance was passed by referring to Article

2, Section 2, which states that "The City shall, in a timely manner, complete necessary changes in ordinances, resolutions, rules, policies and procedures to conform to this agreement, using September 30, 2005 as a target date for such completion." The letter argues that "this language is indicative that the parties knew, and intended, that the changes in retirement benefits could and would not become effective until necessary changes in ordinances were carried out by the City."

We do not believe that Article 2, Section 2 can reasonably be read as a statement of intent regarding the effective date of the benefit changes. It is our understanding that the MOU explicitly provides the benefit changes will apply to employees first hired after July 1, 2005. Article 2, Section 2 simply sets forth a "target date" for completing administrative tasks. The "target date" is neither a firm deadline nor the date that the changes take effect. Under Reed Smith's argument even if the City had enacted an ordinance on September 30, 2005, the changes would not take effect for another 30 days. There would have been no reason for the MOU to set forth July 1, 2005 as the effective date if the parties truly intended for the effective date to be 30 days after an ordinance is enacted. Reed Smith's analysis also disregards the fact that the City passed a resolution on June 27, 2005, well before the target date, ratifying the changes and their effective date of July 1, 2005.

B. *Amendments to the Plan*

Whether the MOU is a plan document is not the only inquiry to determine the effective date of the negotiated changes. A plan may be amended, without creating additional "plan documents," through action taken by the body with the authority to amend the plan. In this case, the MOU and the City Counsel's resolution ratifying the MOU together constitute an amendment to the plan. Under ERISA, every employee benefit plan must set forth a procedure for amending the plan and for identifying the persons who have authority to amend the plan. 29 U.S.C. §1102(b)(3). The Supreme Court has held that this is ordinarily satisfied by stating "the Company reserves the right at any time to amend the plan." *Curtiss-Wright Corp. v. Schoonejongen,* 514 U.S. 73, 75 (1995). The Supreme Court also noted that more elaborate statements or procedures are not necessary because "principles of corporate law provide a ready-made set of rules for determining, in whatever context, who has authority to make decisions on behalf of a company." *Id.* at 101. The Supreme Court explained that under corporate law principles "[a] corporation is bound by contracts entered into it by its officers and agents acting on behalf of the corporation and for its benefit, provided they act within the scope of their express or implied powers." *Id.* at 81. The Supreme Court also noted that amendment authority may be either "by express delegation or impliedly" and that, if the amendment "is found not to have been properly authorized when issued, the question would then arise whether any subsequent actions ... served to ratify the provision ex post." *Id.* at 85.[3]

[3] We assume that California law contains similar principles holding that a city is bound by the acts of its legislative body, but note that we have not researched that issue.

Thus, courts have typically found amendments to plans to be effective, regardless of the form of the action, as long as the person or entity acting had the authority to amend the plan. *See e.g., Johannssen v. District No. 1 Pacific Coast Dist. MEBA Pension Plan,* 136 F. Supp. 2d 480 (D. Md. 2001) (holding that successor employer amended plan by resolution); *Yenyo v. Communications Satellite Corp.,* 899 F. Supp. 1423, 1425 (D. Md. 1995) (where plan document vested the employer with the authority to amend the plan and the employer's board of directors adopted the amendments, the amendment was valid); *Averhart v. U.S. West Mgmt. Pension Plan,* 46 F. 3d 1480, 1489 (10th Cir. 1994) (where the pension plan expressly provides for amendments by a committee subject to approval of the board of directors, amendment was valid even though the board of directors did not pass a formal resolution authorizing the amendment); *Spacek v. Trustees of the Agreement of Trust for Maritime Assoc.-I.L.A. Pension Plan,* 923 F. Supp. 960, 962 (S.D. Tex. 1996) (where plan document authorized the board of trustees to amend the plan, the amendment was valid even if the board did not comply with its own formal procedures for amending the plan), *rev'd on other grounds,* 134 F. 3d 283 (5th Cir. 1998).

The Ninth Circuit has specifically held that corporate action may effectively amend a plan, even when the action is not labeled as a plan amendment, so long as those who took the action have the authority to amend the plan. *Horn v. Berdon, Inc. Defined Benefit Pension Plan,* 938 F. 2d 125 (9th Cir. 1991). The dispute in *Horn* involved the termination of a pension plan, which stated that the company could distribute any surplus to itself upon plan termination if the surplus was the result of an actuarial error. Prior to the termination, the company's board of directors adopted a resolution stating that the plan assets would be distributed to the plan beneficiaries. The company was later sold and the successor company discovered that the plan had a large surplus as a result of an actuarial error. The successor company's board ordered that the surplus be distributed to the successor company, pursuant to the written plan document's terms. However, the Ninth Circuit held that the resolution to distribute the assets to plan participants amended the plan because the resolution was adopted by those who were also authorized to amend the plan on behalf of the company. *Id.* at 127. While no document entitled "Amendment to Pension Plan" was adopted, the Ninth Circuit held that the resolution had the effect of amending the plan because "the only difference between a Plan amendment and a Board resolution is a matter purely of form – the title of the document." *Id.*

In the present situation there is no claim that the City Council lacked the authority to amend the retirement plan. Following the logic of ERISA cases, the June 27, 2005 resolution should be considered to be a plan amendment because it was passed by the same body with the authority to amend the plan. Furthermore, as explained by the Supreme Court, if the resolution was somehow defective, "the question would then arise whether any subsequent actions ... served to ratify the provision ex post." *Curtiss-Wright Corp.,* 514 U.S. at 85. Ordinance O-19567, which merely codified the MOU and the resolution, was a proper ratification.[4]

[4] In contrast, we believe it follows that SDCERS's attempts to bind the plan through resolutions and representations to participants that are not approved by the City Council would have no legal effect if local law does not grant the Board of Administration authority to amend the plan. *See*

The IRS would likely reach the same conclusion if it were reviewing the plan because it has ruled that government resolutions regarding plan benefits are plan amendments. For example, in 1997 the IRS issued a Private Letter Ruling holding that a resolution by a county's board of supervisors was a plan amendment. PLR 9721027. The plan at issue was a multiple employer defined benefit plan for county and municipal employees pursuant to a state statute. In 1982 the state statute provided that members may be eligible for additional service credit if certain conditions were met. One condition was that the service credit provision would not be applicable in a county until it is adopted by ordinance in that county. The county who requested the private letter ruling passed an enabling ordinance on May 12, 1992. In March of 1995, the county's board of supervisors adopted a resolution offering certain employees who retired between March 16, 1995 and March 30, 1995 up to two additional years of service credit. The county asked the IRS to rule that the 1995 resolution was not an amendment because the plan, as embodied by the statute, contained early retirement incentives. The IRS, however, disagreed and found that both the 1992 enabling ordinance and the 1995 resolution "outlining the specific terms and conditions of the early retirement incentive program constitute amendments of [the plan]."

Additionally, the IRS has treated the date of a collective bargaining agreement as the date the plan was amended where the agreement contains terms affecting the plan. *See e.g.*, PLR 8744051 ("the Service is recognizing the collective bargaining agreement as the date the plan was amended for purposes of section 412(c)(8)"). Thus, we think that the IRS would most likely agree that the effective date of the 2005 negotiated changes is July 1, 2005, because that is the date stated in the MOU.

Please note that we have not fully analyzed Reed Smith's arguments regarding the Meyers-Milias Brown Act or proper procedures under the City Code or Charter. However, on the surface, their arguments seem to favor a July 1, 2005 effective date. Reed Smith points out that California courts hold that "when dealing with [public employee benefit contracts] every effort should be made to give full effect to the actual understanding of the parties so as to uphold the integrity of the agreement." (May 4, 2007 Letter, p. 7 citing *Chula Vista Police Officers' Assn. v. Cole,* 107 Cal. App. 3d 242, 248 (1980)). As discussed above, we believe that the MOU sets forth a clear intent to make July 1, 2005 the effective date, regardless of subsequent formalizing action that the City might take. Additionally, Reed Smith argues that the City Charter "expressly" provides that the only manner of amending the retirement plan is by ordinance. But if that were the case, one would have to ask why SDCERS felt the need to pass a resolution stating the same thing. Similarly odd, Reed Smith argues that a plan amendment cannot "operate as an amendment" unless there is a specific reference in the plan incorporating the amendment. (May 4, 2007 letter, p. 5). However, if the "amendment" was already referenced in the plan there would be no need for an amendment.

Section D, below. Our understanding is that the Board of Administration's authority is limited to administration.

Our brief review of the City Code and the Charter leaves us with the impression that they do not "expressly" set forth the method of amending the retirement plan. The Charter does set forth a voter approval requirement that became effective on January 1, 2007, in the event that there is an ordinance amending the retirement system. (Section 143.1). But this does not necessarily mean that an ordinance is the only method of amending the retirement plan. Reed Smith also ignores that the members already voted on the amendments by voting on and approving the MOU. In addition, there would never be members affected by changes for new hires that could vote an amendment that affects only new hires.

C. Anti-Cutback Rules

Reed Smith noted that "state and federal 'anti-cutback' laws likely prohibit a retroactive decrease in vested benefits." It is not just likely but certain that federal law prohibits a retroactive decrease in vested benefits. However, the amendment was not retroactive because it occurred with the execution and ratification of the MOU. For example, the IRS found that there was no retroactive "cut back" where the reduction in benefits was approved as part of a collective bargaining agreement on September 29, 1986, but the "formal plan amendment" was not adopted until February 11, 1987. PLR 8744051. In that case the IRS explained it was "recognizing the date of the collective bargaining agreement as the date the plan was amended." *Id.* Here, no benefits were taken away from any employee who had already accrued them since the changes only apply to employees hired after the date of the City Council's resolution approving the MOU.

Furthermore, the federal "anti-cutback" rules do not prohibit all retroactive plan amendments. *See* Treas. Reg. 1.411(d)-4. Indeed, the correction method for an operational failure (such as failing to follow the plan document) is often to make a retroactive or conforming amendment. *See* Rev. Proc. 2007-26. The anti-cutback rules apply to a limited class of "protected benefits" to the extent that they have already accrued. *Id.* The tax code regulations define "protected benefits" as normal retirement benefits, early retirement benefits, retirement-type subsidies, and optional forms of benefits (meaning where the employee has a choice in how the benefits are paid out). *Id.* Under ERISA the "accrued benefit" is typically expressed in the form of an annual benefit commencing at normal retirement age or the actuarial equivalent. *Robinson v. Sheet Metal Workers' National Pension Fund, Plan A*, 441 F.Supp. 2d 405 (D. Conn. 2006).

The definition of "protected benefits," for purposes of the anti-cutback rules, does not include contingent benefit or "ancillary" benefits such as payment of medical expenses, disability benefits, or social security supplemental benefits. Treas. Reg. 1.411(d)-3(b)(3); Treas. Reg. 1.411(d)-3(g)(2); *Hickey v. Chicago Truck Drivers, Helpers and Warehouse Workers Union*, 980 F.2d 465 (7th 1992). The anti-cutback rules also do not apply to the elimination of the right to future benefit accruals. Treas. Reg. 1.411(d)-3(b)(3)(ii). For example, an amendment to a plan which eliminates the ability to obtain a retirement plan subsidy in the future

does not violate the anti-cutback rules. *See Lindsay v. Thiokol Corp.*, 112 F.3d 1068 (10th Cir. 1997). Reed Smith's letter acknowledges that the 2005 negotiated changes were to "ancillary benefits," not changes to the retirement benefits. While we have not specifically analyzed each of the affected benefits (and the results may be different for different benefit plan features), according to Reed Smith's letter, the "13th check" and purchase of service credit appear to be unvested contingent benefits, the DROP program is an alternative method of accruing future credit, and the health benefits are clearly "ancillary" benefits.

Although we have not analyzed whether these benefits were "vested" under California law for those hired between July 1, 2005, and February 16, 2007, we note that the *Betts* case cited by Reed Smith's letter does not support that proposition. *See Betts v. Board of Administration of the Public Employees' Retirement System*, 21 Cal. 2d 859 (1978). That case held that a state "employee's pension constitutes an element of compensation, and a vested contractual right to pension benefits accrues upon acceptance of employment." *Id.* at 863 (emphasis added). However, the court also explained:

> "the employee does not obtain, prior to retirement, any absolute right to a fixed or specific benefit, but only to a substantial or reasonable pension."

Id. at 863.

D. Correction Methods to Preserve Tax Qualified Status

"Where, as here, the employer has the authority to amend a pension plan and the employer amends the plan through a resolution or vote of a board of directors ... such an amendment is valid." *Johannssen v. Dist. No. 1-Pacific Coast Dist.*, 136 F. Supp. 2d 480, 493 (D. Md. 2001). "Plan administrators are required to follow the plan document and enforce every amendment actually adopted to a plan." *Id.* at 496 citing *Curtiss-Wright*, 514 U.S. at 82. This requires the plan administrator to "sort out" plan communications and implement official actions that are amendments. *Id.* The *Johannsenn* case involved a plan administrator who unilaterally chose to ignore action taken by the employer/plan sponsor because the administrator erroneously believe that the action was not an effective plan amendment. The court noted that a plan administrator has no right to "veto the action taken by the plan's governing body." 136 F. Supp. 2d at 496-97. Likewise, a plan administrator who has no authority to amend the plan cannot "amend or rescind amendments" made by the governing body and any attempt to do so "has no legal effect." *Id.*

In this case, the Board of Administration's resolution purporting to mandate a specific procedure for amending the plan should have no legal effect because it does not appear to have any authority to amend the plan or disregard action taken by the City Council. Likewise, any representation by SDCERS stating that it would disregard the MOU until codified should have no effect because it was a decision to disregard the governing body's resolution amending the Plan. SDCERS does not appear to us to have authority to unilaterally disregard the resolution

and decide upon a different effective date; this should be particularly true where the City Council was ratifying changes already approved by a vote of SCDERS's members ratifying the MOU.[5]

Reed Smith's letter references the Voluntary Correction Program (VCP) available through the Internal Revenue Service. However, the VCP is only one component of the Employee Plans Compliance Resolution System. The component that is available for an "operational failure" caused by failing to comply with plan documents and amendments is the Self Correction Program (SCP). *See* Rev. Proc. 2006-27. SCP does not involve a filing with the Internal Revenue Service or a fee. Rather, it merely requires the plan administrator and/or plan sponsor to take and document "reasonable and appropriate action" to correct the mistake. The City, as the Plan Sponsor, has already done its part by passing the resolution ratifying the MOU and by codifying it by passing an ordinance. The "reasonable appropriate action" for SDCERS would be to comply with the City Council's resolution and not make unilateral decisions to disregard action by the City Council.

Conclusion

It is our position that a court and the Internal Revenue Service applying federal law would consider the MOU to be a part of the plan document and would consider the plan as having been amended by the City Council's resolution ratifying the MOU. Thus, the effective date for the 2005 negotiated changes, as applied to those hired after July 1, 2005, should be July 1, 2005.

[5] SDCERS actions may also be *ultra vires* under California law and may violate statutory administrative procedures. However, that analysis is beyond the scope of this memorandum.

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May 4, 2007

VIA E-MAIL AND U.S. MAIL

David Wescoe
Administrator
San Diego City Employees' Retirement System
401 B Street, Suite 400
San Diego, CA 92101-4298

Re: City of San Diego Memoranda of Understanding Affecting New Employees' Benefits

Dear David:

You have asked us to advise the Board of Administration regarding that certain series of Memoranda of Understanding entered into by and between the City of San Diego and its representative bargaining units, dated as of July 1, 2005 (collectively, the "MOU"), with reference to the provisions of the MOU that relate to reduced retirement and health benefits provided to employees hired after July 1, 2005 ("new hires").

Specifically, you have asked us to advise whether the retirement system may implement the retirement and health benefit provisions of the MOU applicable to new hires effective as of July 1, 2005.

For the reasons set forth in this letter, we conclude that the City Council's Ordinance O-19567 N. S., intending to implement the July 1, 2005 MOU, did not become effective until February 16, 2007, at the earliest. Accordingly, we conclude that it is more likely than not that a court ruling on this matter would determine that the reduced retirement and health benefits provided to new hires under the MOU could not be applied to employees hired before that date. SDCERS should not implement any of the benefit changes as to any City employees newly hired before February 16, 2007.

UNDISPUTED FACTS

Our analysis is based on the following undisputed facts. In the event any of these facts are subject to reasonable dispute or there are material facts that have not yet been brought to our attention, our analysis and conclusions may be different.

1. Prior to July 1, 2005, the City's defined benefit plan for general and safety employees provided for certain retirement allowance formulas and additional ancillary benefits, including a "13th retirement check" payable whenever there are "excess earnings" available in the retirement system at the end of the year, a Deferred Retirement Option Program ("DROP"), a right to

purchase up to five years of additional service credit and retiree medical health benefits. These benefits were bargained for with the City's representative bargaining units, approved by their members, and codified by ordinance of the City Council in the City's Municipal Code.

2. According to SDCERS' tax counsel, Ice Miller, LLP, SDCERS' "plan document" is comprised of portions of the state Constitution, the City Charter, the City Municipal Code, and portions of specified MOUs not codified in the City's Charter or Municipal Code but incorporated by specific reference in the Code (these MOUs relate to credit for certain union presidents' service and compensation.) With few and specified exceptions, the Municipal Code may only be changed by the City Council through formal enactment of ordinances.

3. Section 143.1(a) of the City Charter provides, in relevant part, that "no ordinance amending the retirement system which affects the benefits of any employee under such retirement system shall be adopted without the approval of a majority vote of the members of said system."

4. On June 27, 2005, the City Council passed its Resolution No. R-300600, approving and ratifying new MOUs with its representative bargaining units, to be effective July 1, 2005. Each MOU provided that for employees first hired on and after July 1, 2005, the retirement allowance formula would be fixed and not subject to future increases, and such "new hires" would not be eligible for any of the ancillary benefits listed in Fact #1 above. The typical MOU also provides, in its implementation section:

> *The City shall, in a timely manner, complete necessary changes in ordinances, resolutions, rules, policies and procedures to conform to this agreement, using September 30, 2005, as a target date for such completion.*

5. The City did not adopt an ordinance amending the Municipal Code consistent with the retirement and health provisions of the MOU for new hires until January 17, 2007 (Ordinance O-19567 N. S.). The Ordinance recites, *"This Ordinance contains revisions to the Retirement System as a result of changes in benefits for employees hired on or after July 1, 2005, as agreed to and imposed by the City of San Diego, after meeting and conferring with the City's employee unions."* The ordinance further states,

> *This ordinance shall take effect and be in force on the thirtieth day from and after its final passage.*

The thirtieth day following the passage of the Ordinance was February 16, 2007.

6. There does not appear to have been an affirmative vote of SDCERS' members approving Ordinance O-19567 N. S., as required by Charter Section 143.1.

7. Pursuant to Charter section 144, "the Board of Administration shall be the sole authority and judge under such general ordinances as may be adopted by the [City] Council as to the conditions under which persons may be admitted to benefits of any sort under the retirement system." Section 144 also provides that "[t]he Board of Administration may establish such rules and regulations as it may deem proper..."

8. Since July 1, 2005, SDCERS' personnel have told newly hired City employees that notwithstanding the language in the MOU, SDCERS was required to strictly follow its plan documents; that the Municipal Code had not been effectively amended by City Council ordinance to reflect the benefit changes for new hires after July 1, 2005; and accordingly, SDCERS could not implement the reduction in benefits as to new hires contained in the MOU without jeopardizing the retirement system's tax qualification status.

9. Consistent with its authority under Charter section 144, on July 21, 2006, in open and public session, the Board of Administration adopted Resolution No. R 6-05, titled, "A Resolution of the Board of Administration for the San Diego City Employees' Retirement System Requiring All Amendments to City Retirement Plan be Enacted by Ordinance Specifically Describing the Benefits SDCERS is to Administer." The Resolution provides, in part,

> *WHEREAS, in order for SDCERS to properly administer the retirement benefits established by the City for its employees, and to satisfy its duties under federal tax law, all retirement benefit changes affecting City employees must be enacted by ordinance amending SDMC Chapter 2, Article 4..."*
>
> * * *
>
> *NOW, THEREFORE, BE IT RESOLVED, that the Board will administer the retirement benefits of City employees and retirees in accordance with the terms of the City's retirement plan, as set forth in SDMC Chapter 2, Article 4, and will not implement any benefit changes that have not been enacted by an ordinance amending the plan and, where required, a majority vote of the SDCERS membership..."*

The Board's agenda backup in support of Resolution No. R 6-05, provided in advance of the July 21, 2006 meeting to the public, including appropriate City officials and offices, noted that the Navigant Report prepared for SDCERS earlier that year

> *cited concerns about the ability of the SDCERS actuary to understand and factor into its valuations the myriad benefits offered to members by our Plan Sponsors. These same concerns affect Staff's ability to counsel the members on the benefits, and calculate the benefits accurately. Moreover, under federal tax law, SDCERS is required to administer the plan in accordance with a plan document that satisfies the "definitely determinable requirement," such that the benefits for each member can be computed as expressly provided in the plan.*

Further, the resolution was necessary because "the City Council has often enacted benefit changes: (1) on a retroactive basis, (2) by a method that does not amend the plan document, or (3) without a sufficient description of the benefit amendment."

10. The system's actuary, Cheiron, Inc, prepared SDCERS' annual actuarial valuation report for fiscal year ending June 30, 2006. Cheiron's valuation did not reference the reduced benefit provisions of Ordinance O-19567 N. S.

11. Between July 1, 2005 and March 1, 2007, the City hired 603 new employees, of which 536 remained on active status, 48 were inactive, and 19 had terminated. Four have applied to purchase service credit.

ANALYSIS

A. The Retirement System is obligated to administer benefits in accordance with its Plan Document

As more particularly described in the system's filings in connection with its Voluntary Correction Program ("VCP") with the Internal Revenue Service, the Board of Administration is obligated to administer benefits for its members in compliance with its "plan document." For governmental plans qualified under Internal Revenue Code ("Code") section 401(a), such as SDCERS, the "plan document" consists of its governing statutes and laws, rules and regulations. The Code requires that plans must be administered in accordance with their terms and failure to comply may result in plan disqualification (Code section 401(a) and IRS Revenue Procedure 2006-27.) According to SDCERS' VCP filing, the terms of SDCERS' plan document are found in the sources identified on Exhibit A to this analysis.

Charter section 143.1(a) expressly provides that the Municipal Code respecting retirement benefits (an integral part of SDCERS' plan document) may not be amended without an ordinance duly adopted by the City Council. That did not happen in this situation. In the case of public plans, in the absence of compliance with the plan or statutory requirements for adopting or modifying the plan, courts have been inclined to treat the modifications as failing to become plan terms. For example, in *Picard v. Members of the Employee Retirement Board of Providence,* 275 F. 3d 139 (1st Cir. 2001), the court found that claims by retirees for a cost-of-living adjustment were not valid even though the COLA had been included in a union agreement with the city. The court held that since the union agreement was never properly ratified by the City Council, it was therefore void under Rhode Island law.

The SDCERS' Board of Administration has expressly resolved not to implement any benefit changes unless they are properly adopted by the City Council. Board Resolution 06-05. That resolution was entirely consistent with the City Charter and the City Municipal Code.

B. The MOU is not part of SDCERS' Plan Document

SDCERS' plan document includes portions of certain memoranda of understanding, relating to so-called "presidential leave and benefits" of union leaders. *See* items F, G and H to Exhibit A. Those MOU provisions are expressly incorporated by reference into SDCERS' plan document pursuant to Municipal Code §§24.0201(b) and 24.0301(b). Absent specific reference incorporating memoranda of understanding into the plan document, such memoranda cannot operate as amendments to the plan document binding on SDCERS. Particularly where, as here, the City Charter expressly provides how the City Council must proceed in order to amend the plan's terms for changes in retirement benefits of City employees, the City's MOU negotiated in June of 2005 are ineffective to amend SDCERS' plan document.

C. The MOU likely is not enforceable against new hires until February 16, 2007

The further question arises, as between the City and its employees, are the reduced benefits provided under the 2005 MOU enforceable against employees first hired after July 1, 2005, notwithstanding the City's failure to effectively amend the system's plan document until February 16, 2007? Independent of SDCERS' responsibilities, the issue may well turn on the parties' intentions at the time they ratified the MOUs.

The City may argue that under Government Code section 3505.1 (the provision of the Meyers-Milias-Brown Act ("MMBA") dealing specifically with MOUs), an MOU is binding upon a city after approval by its governing body. *See Glendale City Employees' Assn. v. Glendale*, 15 Cal.3d 328, 336 (1975). While Gov. Code section 3505.1 states only that the parties shall meet and prepare an MOU, "which shall not be binding, and present it to the governing body or its statutory representative for determination," the *Glendale* court interpreted this provision to make the MOU binding upon approval by the city council, observing that "[t]he procedure established by the act would be meaningless if the end-product, a labor-management agreement ratified by the governing body of the agency, were a document that was itself meaningless." *Glendale*, at 336. On this basis the City might argue that new employees hired after the date of City Council ratification were bound by the reduced benefits negotiated under the collective bargaining agreement.

Another court, however, observed that the "MMBA does not prescribe the manner in which an agreement between a local government and an employee organization should be put into effect – in fact, it is silent as to what occurs after a nonbinding memorandum of understanding is submitted to the governing body 'for determination.'" *United Public Employees v. City and County of San Francisco*, 190 Cal. App. 3d 419, 423 (1987) (city council's approval of MOU did not amount to ratification under MMBA or *Glendale* where city charter required voter approval of any amendment to employee benefits system). *United Public Employees* establishes that a city charter may require subsequent action by another body, in this case the SDCERS' members under Charter Section 143.1, before an MOU is ultimately regarded as ratified and binding under *Glendale*.

Courts tend to favor upholding employee benefits contracts where to do so would favor the employees – not the employers. The policy often enunciated is that such contracts should be enforced in accordance with the parties' intent despite minor problems with the parties' performance. *See, Chula Vista Police Officers' Assn. v. Cole*, 107 Cal. App. 3d 242, 248 (1980) ("[s]ince the bargaining power of

public employees has been severely limited by statute (Meyers-Milias-Brown Act; Gov. Code, § 3500 et seq.) when dealing with such contracts, every effort should be made to give full effect to the actual understanding of the parties so as to uphold the integrity of the agreement"); *see also Crowley v. City and County of San Francisco*, 64 Cal. App. 3d 450, 456 (1976).

Here, however, the parties' intent was expressed in terms consistent with the law governing changes to employee retirement benefits. The parties' MOU stated, at Article 2, Section 2:

> *The City shall, in a timely manner, complete necessary changes in ordinances, resolutions, rules, policies and procedures to conform to this agreement, using September 30, 2005, as a target date for such completion.*

This language is indicative that the parties knew, and intended, that the changes in retirement benefits could and would not become effective until "necessary changes in ordinances" were carried out by the City.

Whether the parties to the MOU intended the ordinance amendment requirement to be a condition precedent to the enforceability of the MOU, or only a covenant on the part of the City to perform, is not dispositive. Since the City Charter expressly prohibits changes in employee retirement benefits without the adoption of a formal ordinance, the parties could not privately agree to violate the law – or to require SDCERS to violate the law and jeopardize the retirement system's tax qualification.[1]

SDCERS is without legal authority to implement the change in employee retirement benefits set forth in the MOU until it is effectively made part of the City Municipal Code, and therefore cannot be forced to do so, even if the parties had acted in reliance upon the MOU. *Medina v. Board of Retirement*, 112 Cal. App.4th 864 (2003).

D. State and federal "anti-cutback" laws likely prohibit a retroactive decrease in vested benefits

The Internal Revenue Code contains provisions that prohibit a pension plan from being amended retroactively to reduce vested benefits; those provisions, however, are not applicable to governmental plans such as SDCERS (Code section 411(e)(2).) State law, however, is to the same effect.

Pension benefits are a form of deferred compensation designed to induce employees to remain in public employment. *Kern v. City of Long Beach*, 29 Cal.2d 848 (1947). They become vested when employment commences and services are rendered. *Betts v. Board of Administration*, 21 Cal.3d 859 (1978.) Vested retirement benefits cannot be reduced or otherwise impaired without violating the contract clauses of the United States and California Constitutions (U.S. Const., Art. I, §10, cl. 1; Cal. Const. Art. I, §9); *United Firefighters v. Los Angeles*, 210 Cal. App. 3d 1101 (1989).

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1 Nor may the City take advantage of its own breach of a covenant – to timely pass the necessary ordinance – to enforce otherwise unenforceable terms and conditions of employment against its employees.

Assuming the long delayed City Council Ordinance O-19567 N. S. became effective as of February 16, 2007, any attempt by SDCERS to retroactively adjust benefits downward now likely would be met by a constitutional legal challenge from employees first hired between July 1, 2005 and February 16, 2007. These employees have come into employment without a reduction in benefits having been adopted by the City. Since the plan would not have been administered in accordance with the MOU, a plan correction also would have to be filed with the IRS.

Although the matter is not entirely beyond doubt, based upon all of the facts and circumstances set forth above, we believe that it is highly unlikely a court would apply the reduced benefit levels in the MOU to new employees hired during the period July 1, 2005 to February 16, 2007.

CONCLUSION

For all of the reasons set forth in this letter, we conclude that the City Council's Ordinance O-19567 N. S., intending to implement the July 1, 2005 MOU, did not become effective until February 16, 2007, at the earliest. Accordingly, we conclude that it is more likely than not that a court ruling on this matter would determine that the reduced retirement and health benefits provided to new hires under the MOU could not be applied to employees hired before that date. SDCERS should not implement any of the benefit changes to any City employees newly hired before February 16, 2007.

We will be available to discuss these matters with you and the Board further, as requested.

We understand that SDCERS may wish to share this particular analysis with others, outside of our attorney - client relationship. At your request, we have not identified this as a "privileged and confidential attorney-client communication" or as protected by the attorney work product doctrine. In so doing, neither SDCERS nor we waive the right to treat other communications with us as privileged and confidential or as subject to the work product doctrine.

Sincerely yours,

Harvey L. Leiderman

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